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Introduction

Chairman Allen, distinguished members of the Committee on Foreign Relations, thank you for the opportunity to testify on U.S. foreign assistance programs for the countries of Europe and Eurasia.

When the Berlin Wall fell in 1989 and the Soviet Union collapsed in late 1991, the Europe and Eurasia region became a new frontier for the United States Government. Your committee responded through the authorship of the Support for East European Democracy (SEED) Act of 1989 and the Freedom for Russia and Emerging Eurasian Democracies and Open Markets (FREEDOM) Support Act (FSA) of 1992. From the inception of these acts, USAID has been the main federal agency managing programs to promote democracy and human rights, to introduce and institutionalize a market economy, and to alleviate the social and humanitarian problems in the former communist states of Europe and Eurasia. Our underlying objectives in the region have been and continue to be freedom, peace, prosperity, and regional stability.

Since we initiated work over a decade and a half ago, extraordinary progress has been registered across the region, particularly in the democracy/governance and economic growth areas, though much remains to be done in some countries. Notable achievements include (a) the re-emergence of positive economic growth since 2000 after years of contraction, (b) Freedom House's ranking of 21 of the former communist states as free or partly free with a return to communism unlikely in most countries, (c) Georgia's "Rose" Revolution and Ukraine's "Orange" Revolution, and (d) the significant integration of a number of the region's states into regional and global organizations such as the World Trade Organization (WTO), European Union (EU), and the North Atlantic Treaty Organization (NATO). In fact, performance has been sufficiently good that we have graduated country programs for the eight Central and East Europe (CEE) Northern Tier countries, enabling the closure of the five Missions that serviced these countries ¹. Three more country programs and their attendant Missions will close over the next several years — Bulgaria, Croatia, and Romania.

Still a number of challenges persist – in encouraging economic growth, developing democracies and promoting respect for human rights, improving health, and increasing educational levels.

- Encouraging Economic Growth. Unemployment and the lack of opportunity make a society vulnerable to extremism. A vibrant economy provides jobs and incomes. It allows people to buy houses, farms, and shops and gives them a stake in the future. Job growth that benefits all regions and all ages, particularly the young, is vital to the long-term stability of our region.
- Developing Democracies and Promoting Human Rights. The seeds of democratic change are slow growing but can produce strong results over time - patient support for democratic institutions and human rights in Georgia and Ukraine gave their citizens strong political voices. Support for the persistent voices of freedom and democratic reform - civil society groups, democracy and human rights advocates and movements, and independent media - will prove decisive.
- Improving Health. Collapsing populations, eroding life expectancies, and rising rates of drug abuse and HIV/AIDS are too common in our region. To be viewed as viable, post-Soviet states must ensure that basic health services are available to their people. Improving health status, therefore, is critical to political stability and a significant challenge.
- Increasing Educational Levels. Along with health care, educational attainment was a bellwether of Soviet

success. The erosion of educational levels is seen by many as a symptom of state failure. Lack of educational training also leaves youth ill-prepared to fill today's job needs. Increasing educational attainment, meeting current needs, is a significant challenge to our countries.

The Geopolitical and Security Context

The E&E region continues to be of considerable foreign policy importance to the United States. Countering authoritarianism, human rights violations, and economic stagnation, which together provide fuel for domestic unrest, extremism of various sorts, and international terrorism, is key to protecting U.S. interests in the region.

Since the September 11, 2001 attacks on the United States, the geopolitical and security importance of the countries of Central Asia and the Caucasus has increased dramatically. These states constitute the front line in helping to create stability in a region vulnerable to extremism, drug trafficking, and terrorism. The Caspian region's tremendous oil and gas resources add to its importance to the United States. The proven oil reserves of just two states in the Caspian Sea basin, Kazakhstan and Azerbaijan, are just slightly less than those of the United States. Also, Kazakhstan's Kashgan field is perhaps the largest petroleum find in 30 years ².

In the Southern Caucasus, the region's significant Caspian energy reserves, unresolved ethnic and nationalist conflicts, and the threat of international terrorism, underscore the states' geopolitical and security importance to the United States. Both Azerbaijan and Georgia provide the routes for the planned Baku-Tbilisi-Ceyhan oil pipeline and a South Caucasus Gas Pipeline, together which will bring the Caspian region's vast oil and gas resources to world markets. Also, an uneasy stalemate over Nagorno-Karabakh exists between Armenia and Azerbaijan. In Georgia, separatist movements in Abkhazia and South Ossetia threaten the integrity of the state internally, while the conflict in the neighboring Russian Republic of Chechnya places pressure on regional stability. The simmering conflict in Chechnya also has been tied to terrorist incidents, including the downing of two civilian airplanes, bombings in the Moscow metro, and the tragic attack in Beslan, although not all Chechen fighters are terrorists.

The internecine warfare accompanying the collapse of the former Socialist Federal Republic of Yugoslavia in the 1990s not only caused humanitarian catastrophes but also threatened the peaceful democratic and economic transitions in neighboring post-communist states. The United States and its NATO allies intervened with military, diplomatic, humanitarian, and technical assistance to protect human rights, establish peace, and lay the foundation for sustainable democracies and open market economies. While marked progress has been made in the Balkans since the Milosevic era of the 1990s, ethnic and nationalist tensions and human rights abuses combined with ongoing economic hardship and soaring unemployment continue to drive instability, and the area remains an important geopolitical and security concern to the United States.

Trade with and investment in the E&E region are certain to benefit the United States increasingly. From the natural resources sector to the industrial equipment sector to the service sector and beyond, the United States is broadening its trade relationships with the region. U.S. exports to the region totaled roughly \$7.1 billion in 2003 with direct investment adding to no less than \$4 billion in that same year. USAID's work to combat corruption, promote enforcement of contract and other commercial laws, help E&E countries join the WTO, and lay the foundations for the private sector have helped pave the way for American trade and investment.

Extremism threatens to destabilize several areas within the E&E region. In particular, we must monitor the role of political and radical Islam and the conditions that permit Islamic extremism to flourish. USAID will continue to play a vital role in promoting democracy and respect for human rights in the region. Not only is this the right thing to do, but it avoids adding fuel to the fire for any kind of extremism.

In the National Security Strategy of September 2002, development was officially recognized for the first time as one of the three pillars of national security (along with defense and diplomacy). This represents a profound new understanding of how dangerous failed states are to the security of the United States and the rest of the world and how important development assistance is in dealing with failing and failed states. We cannot ignore those regions in Southeastern Europe and Eurasia struggling to escape the debilitating legacy of communism. Thus, the work of USAID to root firmly democratic, economic, and social reforms in formerly communist, corruption-ridden Eastern Europe and the former Soviet Union, is central to U.S. security.

Indeed, President Bush's National Security Strategy already has yielded fruit in Europe and Eurasia. E&E countries are becoming America's allies. Bulgaria, Estonia, Latvia, Lithuania, Romania, Slovakia, and Slovenia joined NATO in March, 2004; the Czech Republic, Hungary, and Poland had joined the Organization in 1999. The backing of the region's states in the international war on terrorism and of U.S. policy also has been strong. Indeed, nineteen

recipient countries in Europe and Eurasia have been active supporters of Operation Iraqi Freedom, Operation Enduring Freedom, and/or the International Security Force in Afghanistan in 2004.

Finally, America's most important foreign policy and security interest in the region is its relationship with Russia. The United States needs Russia as a strong, reliable, democratic, long-term partner in addressing issues of mutual and global importance such as non-proliferation, counter-terrorism, and HIV/AIDS. Russia also is an energy powerhouse. In 2000, it was the world's second largest exporter of oil, and it holds one-third of the world's proven natural gas reserves ³. Quite apart from development objectives, our maintenance of connections with Russia at a number of levels, including security, military, commercial, and science, to name a few, is vital to U.S. foreign policy interests.

Resources

From the inception of the SEED and FSA accounts through FY 2005, Congress has appropriated a total of \$17.3 billion in assistance under both accounts to the region. This excludes this year's \$60 million Ukraine supplemental appropriation. In coordination with the State Department's Assistance Coordinator for Europe and Eurasia (EUR/ACE), USAID has played a lead role in planning and implementing assistance programs for the E&E region. In FY 2005 – the last year for which monies have been appropriated, USAID administered the lion's share of both SEED and FSA monies, 66% in the case of SEED and 67% for FSA.

The FY 2006 request, including \$382 million for SEED and \$482 million for FSA, will be directed to those remaining gaps defined by the Bureau's Monitoring Country Progress (MCP) system, taking into consideration the best judgment of EUR/ACE, Mission, and Bureau staff on the recipient's commitment, the likelihood of progress, and the need for continued investments.

Joint State Department/USAID Strategic Plan

In order to make the new focus on development in the U.S. National Security Strategy operational, the U.S. Department of State and USAID developed a Joint Strategic Plan (August 2003). It identifies four strategic objectives, twelve subject areas, and thirteen priorities. USAID's E&E Bureau focuses on mainly three subject areas under the objective "Advance Sustainable Development and Global Interests." These are:

- economic prosperity and security;
- democracy and human rights;
- social and environmental issues.

In addition, USAID programs in the E&E region advance the joint strategy's subject areas of regional stability, international crime and drugs, humanitarian response, and public diplomacy ⁴. We promote regional stability through our conflict resolution work - most of which takes place at the grassroots level - in the Balkans, the Caucasus, and Central Asia, and, with Economic Support Funds, Cyprus and Northern Ireland. Our work in helping to strengthen laws and judicial systems and in promoting transparent and accountable public and private institutions together which combat corruption contributes to minimizing the impact of international crime and drugs on the United States and its citizens. In the unfortunate cases when it has been necessary, we have provided humanitarian responses due to crises in the Balkans, the Caucasus, and elsewhere. Also, through public outreach in Mission-level strategy development as well as training and exchange programs, our Agency has been involved in public diplomacy and public affairs.

The priorities from the State-USAID strategic plan with high relevance in the E&E region are:

- democracy and economic freedom in countries in the region with significant Muslim populations,
- alliances and partnerships, particularly the strengthening of (a) ties to NATO and the EU and (b) U.S. bilateral relationships with Russia and other E&E countries and allies in Asia and the Middle East, and
- HIV/AIDS prevention, treatment and care.

White Paper

USAID has produced a document "U.S. Foreign Aid: Meeting the Challenges of the Twenty-first Century," the so-called "White Paper" that provides the framework for all its work. The core goals within the USAID "White Paper" are to (a) promote transformational development consisting of sustained democratic, economic, and social change, (b)

fortify fragile states, (c) support strategic states as determined by the Department of State and the National Security Council, (d) provide for humanitarian help, and (e) address global and transnational issues and other special concerns, e.g., HIV/AIDS. While a number of E&E countries or entities can be classified as fragile (Bosnia-Herzegovina, the Kyrgyz Republic, Serbia and Montenegro, and Tajikistan) or strategic (Cyprus, Kazakhstan, Kosovo, Northern Ireland and the Republic of Ireland, Russia, Turkey, Turkmenistan, Ukraine, and Uzbekistan), the greatest proportion of activities, even in fragile or strategic countries, are transformational development in nature. The White Paper also disaggregates countries by income status (low income, middle income) and commitment to reform (weak, fair, good, top).

Results

USAID is pleased to report to Congress that those programs that we administer are having a profound impact on the lives of the populaces of our recipient countries.

Economic Prosperity and Security:

- In Azerbaijan, our program in agriculture has created over 35,000 jobs, working with over 150 enterprises that have entered new markets. Also, a 100-member Agro-Input Dealers Association that we helped create is providing fertilizer, seeds, and other agricultural chemicals to some 40,000 farmers through a network of dealerships associates.
- While we have a number of credit programs in the region that are providing for jobs, at the forefront are those for Russia. Under the credit programs that we support, small and medium enterprises were provided last year over 51,100 loans worth \$83 million. These loans created or sustained some 82,700 jobs by enabling these enterprises to grow their businesses 200 to 300 percent on average.
- To spur much needed investment in Bulgaria that would provide for additional jobs, we helped the country to promulgate a new Law on the Promotion of Investments, develop a National Investment Strategy, produce an "Invest Bulgaria 2004 guidebook," and promote the institutional development of the National Council for Economic Growth - now the leading body for public-private dialogue and policy formulation. The end product is a share of foreign direct investment in GDP that is approaching 10 percent, the highest in Eastern Europe.
- We have assisted in the establishment of a robust mortgage industry in Kazakhstan, a development that is providing for much appreciated housing for the country. Residential and mortgage lending surpassed \$564 million last year, a \$200 increase from the preceding year, owing to the creation of the Kazakhstan Mortgage Company that helped make housing more affordable.
- USAID provided business and trade advisory services to 81 companies in the Kyrgyz Republic, producing portfolio growth in excess of \$18 million that provided for sales increases of 76% and productivity hikes of 66% for assisted enterprises.
- Major advances in business registration were achieved in Ukraine. Our program, active in more than 130 cities across the country, reached 70,000 enterprises via the hotline that was put in place, decreased the cost of business registration by 55% on average, reduced the time to obtain licenses and permits by about 50 percent, and lowered significantly the number of visits to government agencies, in addition to dropping corruption in the process by 84%.
- In the energy area, we helped introduce new energy laws in both Bulgaria and Macedonia, privatize seven electricity distribution companies in Bulgaria, and hike by \$2.2 million collections by the state electricity entity in Georgia, among other accomplishments.

Democracy & Governance

- Years of USAID democracy support contributed to the peaceful democratic transitions that displaced corrupt, semi-authoritarian regimes in both Georgia and Ukraine. In both countries, USAID played a critical support role in fostering the development and maturation of civil society groups that ultimately mobilized to decry wide-scale electoral fraud. USAID also played an important role in helping civil society organizations to conduct necessary oversight over electoral processes. After fraudulent elections, this led eventually to elections which reflected the will of the people.
- In Croatia, USAID support has led to the vibrant growth of service delivery and issues-based advocacy NGOs, which in 2004 enabled the mobilization of 62,000 citizens in advocacy-related campaigns and the delivery of critical social services to 37,000 of the country's most vulnerable citizens.
- Through USAID assistance, the Macedonian Parliament increased transparency, conducting its first ever public hearings on key draft legislation that resulted in positive legislative reforms. In addition, 24 members of Parliament (MPs) opened new constituent offices, bringing to 60 the number of such members who hold regular meetings with the public.
- Over a dozen indigenous NGOs that have served as electoral process "watchdogs" in their own countries in

Europe and Eurasia have begun to work together in observing elections in the region with USAID's sponsorship. This organization, the European Network of Election Monitoring Organizations, fielded approximately 1,000 monitors for the second and third rounds of the Ukrainian presidential election and will send observer missions to the parliamentary and presidential elections in the Kyrgyz Republic.

- Throughout the region, independent media assisted by USAID and its partners are forcing governments and politicians to answer difficult questions, are opening up the airwaves and newspapers to stories that reveal both crime and corruption, and are providing important information to improve the lives of people.

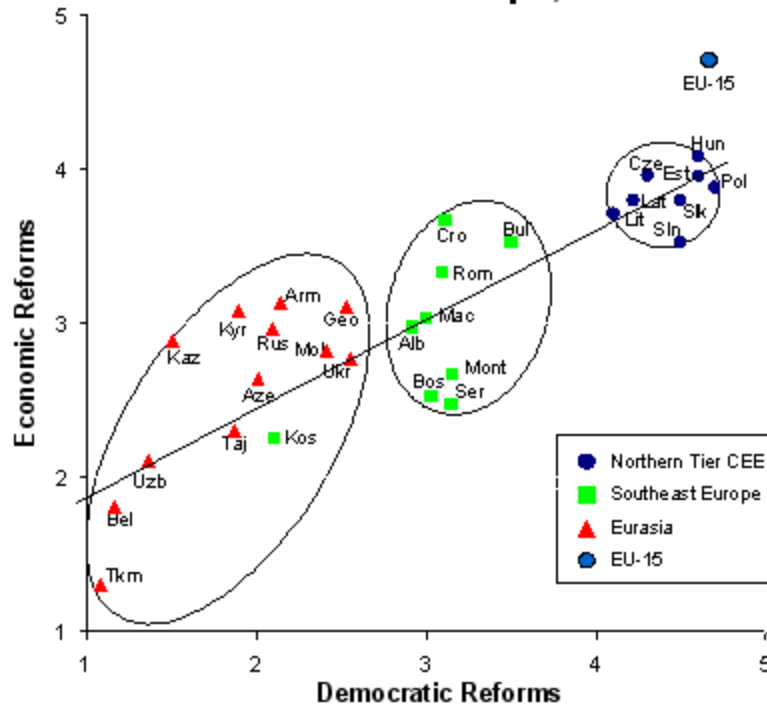
Social & Environmental Issues

- Generally speaking, USAID has helped (a) control the diphtheria epidemic in Eurasia, (b) demonstrate internationally-approved and cost-effective TB control approaches, (c) offer women alternatives to abortion, (d) revolutionize care for orphans and vulnerable children, (e) strengthen pension programs for retirees, (f) improve the targeting of social benefits, and (g) make teaching methods more effective.
- In Kazakhstan, where USAID has supported tuberculosis control efforts since 1998, TB deaths have decreased 41.6% between 1998 and 2003, and the Centers for Disease Control calculates that the USAID-supported TB control strategy has saved more than 20,000 lives during that time.
- In Romania, USAID pioneered community-based programs to reduce abandonment and institutionalization of children. The steady decline in the number of children abandoned in institutions over the past decade – from over 100,000 to just over 24,000 – demonstrates increased effectiveness of community services provided to vulnerable groups. In the past year alone, 11,300 more children received community services than the year before, bringing the total number in community care to more than 76,800.
- In Ukraine, USAID's Maternal and Infant Health Project has introduced evidence-based best practices for the care of mothers and their newborns. These practices have resulted in more rapid weight gain for mothers and their newborns, the near elimination of newborns that become hypothermic after birth (from 63 percent to near 0 percent), and an increase in "normal" deliveries from 22 percent to 68 percent. Based on this success, numerous other health care facilities have requested to be included in the project. In addition, USAID/Ukraine reports that its family planning interventions have contributed to an almost 50 percent reduction of the abortion rate over the last five years.
- USAID's Healthy Russia 2020 program recently received endorsement from the Ministry of Education for a family life and health education curriculum that is expected to be used throughout the country - the first such curriculum in Russia.

The USAID Program

USAID's principal goal within the E&E region remains the establishment of functioning democracies that have open, market-oriented economic systems and responsive social safety nets. We will work to address the large disparities among E&E countries that exist in progress toward economic and democratic reforms (see the following chart). The eight countries of the European Northern Tier are well advanced in their transition to market-oriented democracies. Southeastern European countries have been plagued by instability from ethnic conflict throughout much of the 1990s and the disintegration of Yugoslavia. However, in recent years, reform progress among these countries has been impressive. In contrast, reform progress has lagged considerably in many Eurasian countries, particularly in democratization.

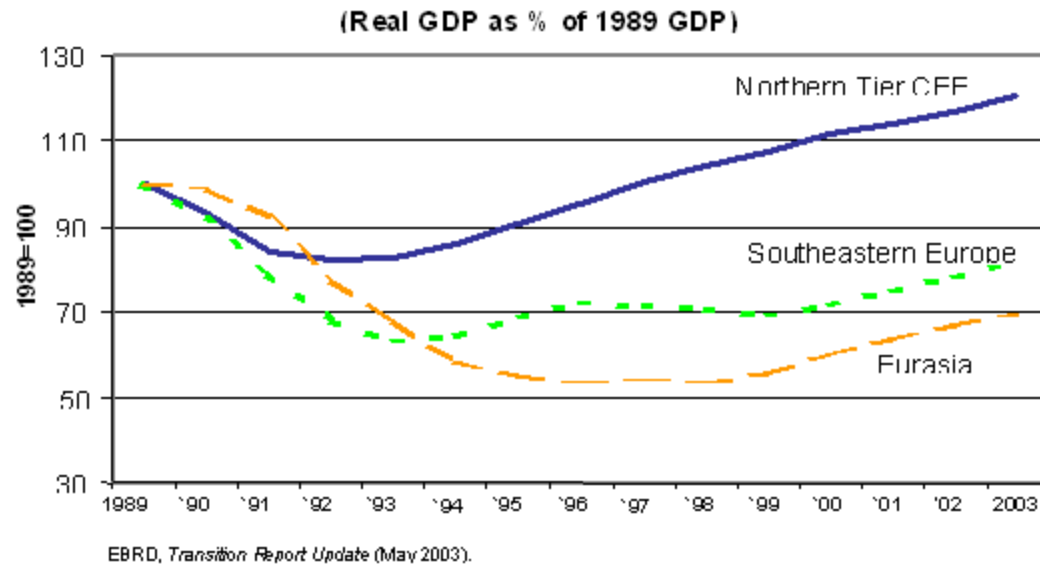
Economic Reforms and Democratic Freedoms in Central and Eastern Europe, and Eurasia: 2004



Ratings are based on a 1 to 5 scale, with 5 representing most advanced, drawing from Freedom House, *Nations in Transit 2004* (2004), and EBRD, *Transition Report 2004* (November 2004).

Assistance Area 1. Economic Prosperity and Security

Across the E&E region, per capita income in 2003 is only one-fourth the average of advanced European economies, despite 5.2 percent annual economic growth since year 2000. Among E&E countries, only the CEE Northern Tier has sustained healthy annual rates of economic growth over an extended period of time (averaging 4 percent since the mid-1990s). This has been sufficient to raise GDP in that sub-region 20 percent above 1989 levels (please see the chart below). On the other hand, in 2003, GDP in Southeastern Europe averaged about 10 percent below 1989 levels, and, in Eurasia, it averaged 30 percent below. Still, since 1999, economic growth has been the highest in Eurasia, though driven by factors, some of which may not last, including price increases for primary product exports (energy, metals, and cotton) and devaluations following the 1998 Russian financial crisis. Economic progress in the western Balkans countries, as well, remains fragile, due to weak global integration (small export sectors and little foreign direct investment).



Several E&E countries view agriculture and related rural enterprise development as potential sources of growth. However, rural economies in many of these countries have been held back by relatively poor market infrastructure, excessive State controls, and lack of access to finance. These problems are exacerbated by agriculture subsidies imposed by the developed world that undermine the international competitiveness of E&E agricultural products.

While the share of the economy controlled by the private sector has increased very impressively in nearly all E&E countries (excluding Belarus, Bosnia-Herzegovina, Serbia and Montenegro, Turkmenistan, and Uzbekistan), the international competitiveness of economies has shown little improvement, particularly so in Eurasia where monopolistic markets often prevail. In general, private enterprise in the region is inadequately prepared to participate in the global economy. Old systems for supplying inputs and for collecting and distributing products have collapsed, and new ones have yet to emerge. Institutions that support and regulate markets are weak.

Unemployment looms large as an issue, especially in Southeastern Europe where rates on average exceeded 20 percent in 2003, including a whopping 42 percent in Bosnia-Herzegovina. In Eurasia, while official unemployment rates are generally in the single digits, the region is characterized by considerable underemployment. Many workers in the region either have (a) poor-paying jobs in the informal sector or (b) employment with state enterprises in which there is little actual work or pay. Generally speaking, youth in both sub-regions are disproportionately affected.

More generally, E&E will target small and medium enterprise (SME) development across most of its recipient countries. Engines of economic growth, competitive SMEs can increase productivity, create jobs, provide incomes for an emerging middle class, and spearhead integration into regional and global economic systems. To stimulate SME growth, E&E will focus on (a) policy issues and (b) the development of clusters providing for enhanced competitiveness through the forging of linkages between economic agents and institutions. SME growth also depends on the adequacy and availability of appropriate labor skills. Hence, workforce development programs may be pursued to make SMEs more productive and competitive.

An important aspect of SME development is country performance in agriculture. As our recipients reform, we will increasingly move within the agricultural sector from taking on policy issues to the development of markets, both internal and external. Within our market development work, competitiveness will increasingly emerge as a thrust.

For selected SEED and FSA middle-income countries (Albania, Belarus, Bosnia-Herzegovina, Bulgaria, Croatia, Kazakhstan, Macedonia, Romania, Russia, and Serbia), a big push will be made to integrate them into global markets. These countries are better prepared to enter global markets. Hence, trade and investment promotion will take precedence in these countries.

Most first stage economic reforms (liberalization of domestic prices, trade, and foreign exchange regimes and small-scale privatization) have been accomplished, except in the three Eurasian weak-performers (Tajikistan, Turkmenistan, and Uzbekistan). Therefore, most remaining policy assistance will emphasize second stage reforms that focus on building market-based institutional capacity and better public governance.

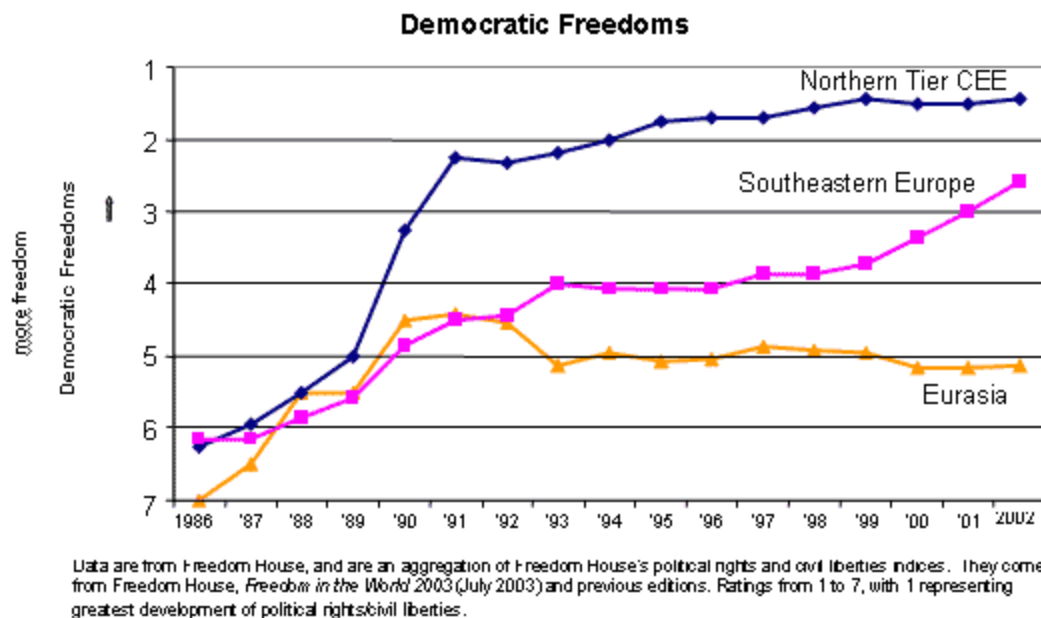
For their part, commercial law and property rights adjudication, important keys to the promotion of foreign investment, constitute complex issues that will be pursued across all our recipients, especially those recipients that possess a deep commitment to reform.

We also have much unfinished work in the energy sector. Energy is an extremely important issue for E&E, and E&E Missions must remain engaged. Energy sectors are large especially in our Eurasian recipients, owing to their significant petroleum and natural gas sectors. Energy sectors also pose a major drain on government resources. Until energy sectors are reformed and efficiency gains realized, governments will not be able to devote the resources needed to address other critical problems, e.g., health and education. The deterioration of heating systems and the affordability of heat to the poor remain major economic and social problems in some countries.

Assistance Area 2. Democracy and Human Rights

Although much of the region has not yet achieved the prosperity, peace, and security expected in the post-Soviet era, the level of personal freedom that exists today is well beyond what millions in this region knew for decades, and people do not want to lose these freedoms. For the most part (with the exception of Belarus, Turkmenistan, and Uzbekistan), the totalitarian impulse to interfere with citizens' private matters (beliefs, choice of work, travel, etc.) is no longer pervasive. Sadly, however, among many of the states in Eurasia, a perceptible movement back towards authoritarian patterns of political authority is being felt in a number of areas, including constraints on freedom of the press, restrictions on political activity and competition, executive influence over judiciaries, and discrimination against minority religions. Significantly, Russia dropped in Freedom House's rankings in its global survey of democratic freedoms from "partly free" to "not free" in 2004.

The remaining challenges facing democracy and governance are generally far greater in Eurasia than in Southeastern Europe. Since the collapse of the Soviet Union, democratic freedoms have generally stagnated in most of Eurasia, and the gap between Europe and Eurasia in building democracy continues to widen (please see the chart below)



Because democratic reforms are stalled or regressing in most countries in Eurasia except Georgia and the Ukraine, most areas of assistance in democracy and human rights will be emphasized in that region, including municipal governance, rule of law, independent media, civil society including human rights advocacy, and political party development and elections. Especially important in the coming year will be assistance to support elections that meet OSCE standards in countries such as Azerbaijan, the Kyrgyz Republic, and Moldova, in addition to Macedonia in Southeastern Europe. Southeastern Europe is relatively advanced in civil society and electoral processes, so in that

sub-region the other forms of democracy and governance assistance will receive greater emphasis. As for states that are considered to be fragile, an important theme of programs early on was ethnic and religious tolerance.

Ethnic Extremism and Islam

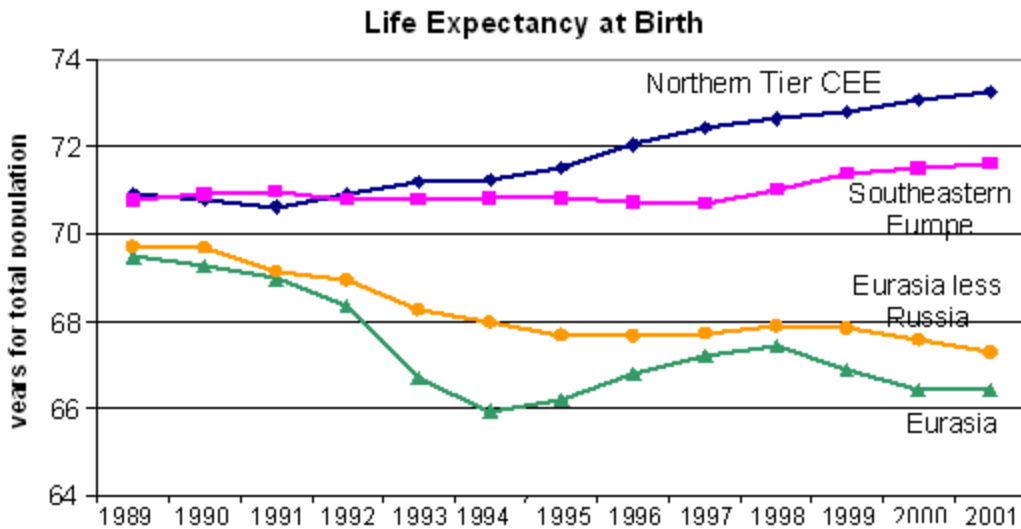
Ethnic and religious extremism is a major source of instability in several sub-regions within E&E. In particular, we need to encourage Islam to be a source of stability, rather than instability, within the region. Several of our recipients' governments actively discriminate against Islamic communities, a development that encourages radicalism. Diminution of the role that Islam plays in serving as a source of instability can be best accomplished through encouraging economic, democratic, and social development, since extremist behavior is often linked to socially, economically, and politically disenfranchised populations. We will consider (a) institutional mechanisms that encourage all groups of citizens to feel that they are part of the State and (b) specific educational and communication programs that promote the discussion and advancement of democracy, religious freedom, and economic liberty within the context of both secular and religious world views ⁵. USAID already has active programs to reduce tensions between or discrimination against religious groups in Kosovo, Macedonia, Uzbekistan, and elsewhere. E&E also will fund research to monitor such discrimination.

In addition, we are especially cognizant of the need to provide for meaningful employment opportunities in Islamic-majority countries and regions such as Albania, Central Asia, and the North Caucasus. Absent political rights, jobs, and hope, segments of the countries' communities are more vulnerable to extremist rhetoric and may be drawn to radical Islamic elements and terrorism.

Assistance Area 3. Social and Environmental Issues

Early assumptions that Soviet health and education sectors and social safety nets for vulnerable groups would survive and sustain the transition have often proven false. Indeed, the social transition has produced very disappointing indicators, revealing widespread declines in many aspects of health and education, degradation or elimination of social safety nets, and increased vulnerability of youth and other social groups. The fact that the majority of people in many E&E countries today are living less well materially than they did before the Soviet bloc crumbled threatens to undermine constituencies for economic and democratic reform in countries where people fail to perceive benefits from those reforms.

The difference between the Southeastern European and Eurasian sub-regions in health indicators demonstrates an especially alarming pattern of decline which is summarized starkly by divergence in life expectancy (please refer to the chart below). Life expectancy is rising in Southeastern Europe and falling in Eurasia. Based on data for 2002 - the latest available, the largest gender differences in life expectancy worldwide also are found in Eurasian countries. Russian females with a life expectancy of 72, for example, live 13 years longer than Russian males (59 years). In contrast, the spread is 6 years in Western Europe and 7 years in the European Northern Tier countries. In sum, while in 2002 life expectancies averaged between 72 and 74 years in Southeastern Europe, they stood between 65 and 69 years in Eurasia. The rapid spread of infectious diseases combined with lifestyle behaviors and resultant diseases are contributing greatly to the health crisis in Eurasia.



World Bank, *World Development Indicators* 2003 (April 2003). Missing data were estimated by interpolation.

Major health risks or demographic pressures that threaten the sustainability of reform include:

- fast growing HIV rates, particularly in Russia, the Western NIS states (Belarus, Moldova, and the Ukraine), and the Baltic countries (Estonia, Latvia, and Lithuania);
- a tuberculosis (TB) epidemic that continues to soar and is exacerbated by increases in HIV/TB co-infection and Multi-Drug Resistant TB, such problems being most salient in the Central Asian Republics (CARs), notably Kazakhstan (the other CARs are the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan);
- high infant and child mortality rates in the CARs and the Caucasus (Armenia, Azerbaijan, and Georgia);
- continued high rates of abortion and maternal morbidity in Azerbaijan, the CARs, Georgia, Moldova, and Romania;
- aging and shrinking populations combined with declining life expectancy in Eurasia;
- the decline in the capacity of health finance and delivery systems to address the evolving epidemiology and demographics;
- cardiovascular and other non-communicable diseases that account for three-fourths of all deaths (many prematurely); and
- little attention to disease prevention and continued risky behaviors that reduce life expectancy.

The stock of human capital varies considerably across countries – highest in Slovenia (and the other European northern tier countries) and lowest in Tajikistan (and in the remaining CARs and the Caucasus). Some indicators allow optimism that the worst of the social deterioration already may have occurred. For example, trends in real wages and, possibly, education expenditures and secondary school enrollment shares (the share of the population aged 15 to 18 that is attending secondary school) are slowly improving in a majority of E&E countries. Secondary school enrollment shares had declined in Eurasian countries from 60-70 percent in 1989 to 30-40 percent in the early 2000s; declines, albeit not as great, also had taken place in these same countries at the primary level.

Health will be an increasing concern for all E&E's Missions, building upon USAID experience to date. High abortion rates and low contraceptive rates throughout the region require continued attention to reproductive health in most E&E countries. E&E will focus on child survival and maternal health interventions in countries of greatest need. The Caucasus countries and the CARs have the highest under-five mortality rates in the transition region. Almost all our recipients are encountering difficulties with infectious diseases, including HIV/AIDS and tuberculosis (TB), and HIV/AIDS and TB funds will be targeted in those countries where infection rates for these diseases are highest, most notably Russia, Ukraine, and Central Asia. Also, work in health systems and administration will be entertained principally in those countries where there is commitment to reform, e.g., Albania and Uzbekistan, although it also could be pursued in other countries to build commitment and improve system efficiencies.

Especially through further collaboration with the World Bank and other donors, education assistance to selected countries/entities in Eurasia (Azerbaijan, Tajikistan, Turkmenistan, and Uzbekistan) and Southeastern Europe (Kosovo, Macedonia) has particularly high long-term potential. E&E will continue its existing basic and secondary

education program in Central Asia, with vocational education an added emphasis in selected countries. Also, general university education in countries where E&E has already established a role, e.g., selected middle income Southeastern European countries, will be supported, in addition to university-level business management education.

We will address social protection and labor issues. E&E also will sponsor workforce competitiveness studies that identify skills training and labor market reforms required to spur economic growth. Finally, social sector reforms to deal with corruption will be an important element of E&E's programs; we will seek to eliminate rent-seeking in the delivery of services in both the health and education sectors.

Cross-cutting Assistance Areas

While some of the most important USAID priorities do not easily fall into the above three assistance areas, they are indispensable for achieving our basics goals, including values and social capital, corruption, trafficking in persons, and conflict.

Values and social capital

USAID has always recognized that sustainable development is strongly supported by widespread acceptance among the beneficiary population of certain values necessary to the fair and efficient functioning of the State and the economy. To provide for values supportive of economic, democratic, and social development, E&E programs will more consistently seek ways to build social capital. The term "social capital" refers to the prevalent mindset that results in voluntary compliance with established laws, trust, cooperative behavior, and basic codes of conduct ⁶.

Social capital has deteriorated significantly in the E&E region since the transition began a decade and a half ago. Academic analysts, news media, and donors have generally underestimated the degree to which weak social capital in the former Soviet Union and the Eastern Bloc has undermined efforts to promote democratic and economic reform. Differences in the stock of social capital account for the pattern across the E&E region in which countries that experienced a longer and deeper exposure to communism have shown a slower pace of reform in the post-Soviet era.

Our task is to seek ways to append a values and social capital enhancement dimension to existing programs. Likely involving more attention to youth, possible program areas include:

- values education, including the development of curricula in the area of character education. Materials could be gathered and disseminated which rely on indigenous historical, literary, religious, and political figures who embody the values that need to be cultivated such as integrity and honesty;
- exchange programs and training exercises that promote ethnic and religious tolerance;
- media projects, both written and visual, which feature leadership and visionary characteristics; and
- activities that strengthen civil society relationships. Positive values will emerge when citizens participate in civil society structures and see the benefits they bring.

Corruption

Corruption is endemic to much of the E&E region. The corruption index compiled by Freedom House scores 17 E&E countries at five or higher on a scale where "7" represents the worst level. Recent surveys confirm that citizens view endemic corruption as one of the region's most serious societal problems, ranking close behind poverty, political instability, and crime. In the presence of corruption, the Bureau's transition goals (democracy, economic, and social) have been slowed or blocked. In sum, while programs directed specifically at reducing corruption may be undertaken, an orientation toward reducing corruption will run through numerous programs in countries where it is a widespread problem.

The E&E strategic approach to addressing corruption promotes transparency, accountability, prevention, enforcement, and education. We are promoting transparency through our work to create open, participatory governments. We promote accountability through support of (a) checks and balances amongst government branches and from outside sources such as independent media, trade associations, and political parties, (b) inspector general functions, and (c) the decentralization of power to other layers of government. Our programs support prevention of corruption through the systemic reform of institutions and laws to decrease opportunities and incentives for rent-seeking behavior. USAID is working to promote enforcement through the consistent application of effective standards and prohibitions. Finally, USAID programs support educational efforts that point out the adverse

consequences of corruption, the tangible benefits of reform, and the concrete potential for positive change. Our approach to corruption also relies on USAID's new agency-wide Anti-corruption Strategy.

Trafficking in persons (TIP)

TIP is a major issue in the E&E region; as many as 25 percent of trafficking victims worldwide come from the E&E region. The USG considers human trafficking to be a multi-dimensional threat. It deprives people of their human rights and freedom; it is a global health risk; and it fuels growth of organized crime. Some of our field Missions already address TIP through activities which strengthen local government, promote SME development, support advocacy groups, utilize media to sensitize potential victims and populations, emphasize the health-related needs of victims, and fortify the rule of law.

When targeting TIP, efforts on the part of the USG, including those of USAID, should focus on the three "Ps," namely Prevention, Protection, and Prosecution:

- Prevention of TIP through economic empowerment; crisis prevention; public education and awareness; capacity building of government, NGOs and the media; and legal reform and implementation;
- Protection of victims through assistance for government and NGO referral services and protection of witnesses; and
- Prosecution of criminals through improved judicial coordination ⁷.

Increasingly, we are expanding the anti-TIP paradigm to include the three "Rs," consisting of rescue, removal, and reintegration of victims.

Conflict Management and Mitigation

In the wake of the collapse of the Soviet bloc, political and ethnic tensions have risen and fueled bloody conflict in the name of national and ethnic liberation. For example, between 1991 and 1995, over 300,000 people lost their lives in violence associated with the break-up of Yugoslavia. The E&E Bureau has integrated its conflict mitigation efforts within its work in each of the three transition subject areas. In order to address conflict vulnerabilities, we encourage programming that implicitly builds social cohesion, communication, and understanding. This type of programming might include regional cooperation, the promotion of economic growth via SME development, the empowerment of communities through the collective resolution of practical local issues, support for civil society advocacy actions, the engagement of idle youth, the decentralization of government for improved service delivery at the local level, and the promotion of transparency by strengthening actors and institutions related to the rule of law. Notable activities include tolerance projects in both Bosnia-Herzegovina and Russia and the assessments for Kosovo and Serbia and Montenegro led by the Agency's Conflict Management and Mitigation Office.

The Millennium Challenge Account (MCA)

Announced on March 14, 2002 by President Bush, the MCA is designed to provide additional assistance to countries that have met specific indicators related to ruling justly, investing in their people, and encouraging economic freedom. With strong bipartisan support, Congress authorized the Millennium Challenge Corporation (MCC) to administer the MCA and provided \$1 billion in initial funding for FY 2004. President Bush's request for the MCA in FY 2005 was \$2.5 billion, of which Congress appropriated \$1.5 billion. The President has pledged to increase funding to \$5 billion per annum in the future. These funds can be an important tool in helping leverage significant reforms.

The MCC, which administers the MCA and for which USAID Administrator Natsios is a board member, met in May, 2004 and identified sixteen countries as eligible for MCA assistance, including Armenia and Georgia from the E&E region. The MCC Board also approved a "Threshold Country" program which will be directed towards a number of countries that have not met the requirements for MCA eligibility but demonstrate significant commitment to meeting those requirements. From the E&E region, the Board selected Albania to be eligible for threshold country status. New candidacy criteria for FY 2006 may provide MCA-eligibility and threshold status for more E&E countries.

All USAID Missions in the E&E region will work to encourage our recipient countries to focus on MCA's criteria of ruling justly, encouraging economic freedom, and investing in people.

Phase Out of USG Assistance

The USG Government always has planned that assistance to the region would be temporary, lasting only long enough to ensure successful transition to sustainable, market-oriented democracies with responsive social safety nets. The performance of Bulgaria and Romania in FY 2002, the year the two countries were notified that they would be accepted into NATO, is used as thresholds, representing sufficient transition performance to phase out SEED and FSA assistance. Accession to NATO demonstrated that the two countries had progressed to the point that they had reached the irreversible path to becoming market-oriented democracies. USAID/E&E's MCP system provided the analytical base for systematic interagency review led by EUR/ACE to establish time frames for the phase out of USG assistance in all our recipients. Through this interagency, analytical process, phase out dates have been determined for each of the economic, democratic, social, and law enforcement sectors for our Southeastern European and Eurasian recipient countries. These phase out dates have been identified for planning purposes and do not convey any commitment to funding levels or entitlement to assistance until the established dates. USAID/E&E's Bureau also uses these data to adjust strategies to address remaining gaps and maximize the impact of USG assistance.

Over the next several years, three country programs will graduate and their Missions will close, including Bulgaria, Croatia, and Romania. In addition, we plan to phase out of the economic sectors in Kazakhstan, Russia, and Ukraine also over the next several years. These decisions all assume that performance continues as projected. Across all the region's countries, E&E will monitor closely transition indicators using the Bureau's MCP system as well as Mission and Bureau staff understanding of problems, progress, and prospects in each sector.

Cyprus, Northern Ireland and the Republic of Ireland, and Turkey

The E&E Bureau also administers Economic Support Fund (ESF) allocations for Cyprus, Northern Ireland and the Republic of Ireland, and Turkey, and the FY 2006 request includes \$42 million in such allocations. Turkey, as a front line state against the war on terrorism, will benefit from \$10 million under the FY 2006 request; Cyprus, \$20 million; and Northern Ireland and the Republic of Ireland, \$12 million. For FY 2005, \$13.4 million had been appropriated for Cyprus; \$21.8 million for Northern Ireland and the Republic of Ireland; and zero for Turkey. Turkey, however, had received \$10 million in FY 2004, and these monies funded activities, including (a) support for a World Bank pre-natal care and education activity under the Bank's Social Risk Mitigation Project; (b) an International Office of Migration anti-trafficking activity; and (c) a business partnering program implemented through the American Chamber of Commerce. As for Cyprus and Northern Ireland, past allocations have supported reconciliation and conflict resolution amongst warring factions. For their part, monies that Cyprus received in the past also have been funding partnership activities for economic growth and a scholarship program. An important intermediary for the Ireland monies is the International Fund for Ireland.

Conclusions

We are proud of our successes in the E&E region, a region that remains of considerable foreign policy importance to the United States. Our programs, which are integrated into the frameworks set by the National Security Strategy, the Joint State/USAID strategy, and the USAID "White Paper," have permitted us since the fall of the Iron Curtain to make tremendous strides in furthering democracy, installing market-based economic systems, and tending to the social and humanitarian needs of the former communist states of Europe and Eurasia. We are very aware that there is much left to be done. In particular, the post-Soviet states of Eurasia appear to have long transition path ahead of them. As new priorities emerge in other parts of the world, I would urge the distinguished members of the Senate Foreign Relations Committee to support our Budget and Operating Expense requests that are focused, for the most part, on countries that demonstrate a commitment to sound development principles and democracy. Allocations at such levels would help us to achieve our overriding goal in the region - the establishment of market-oriented democracies with responsible social safety nets. Our very close working relationships with the State Department Coordinator would allow us to program resources in a way that would help us meet that goal.

Finally, it is imperative that our work stay the course, despite the difficulty of the task and the occasional bumps along the way. After a decade and a half working in the region, we have learned that pre-mature disengagement can have enormous costs in the long-run. Many of our programs have long gestation periods. A case in point is Ukraine. We spent a number of years building up civil society, and a mature civil society together with timely elections assistance were the key tools that the country's populace required to carry out the largely successful "Orange" Revolution.

In the end, final victory can only be secured by the will of the people, not by the assistance of international donors. We can, however, be a responsible supporter of the aspirations of free people and those that long for freedom.

Thank you, Mr. Chairman.

¹The Northern Tier consists of the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia; Southeastern Europe, Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Macedonia, Romania, and Serbia and Montenegro, in addition to the province of Kosovo; and Eurasia, Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, the Ukraine, and Uzbekistan.

²*National Energy Policy*, pp. 8-12, Report of the National Energy Policy Development Group, GPO: May 2001.

³*National Energy Policy*, pp. 8-12.

⁴The other joint strategic subject areas are: counterterrorism, homeland security, weapons of mass destruction, support of American citizens, and management and organizational excellence.

⁵See *Strengthening Education in the Muslim World*, PPC, June 2003.

⁶The phrase "social capital" has been used in recent times by many scholars (e.g., James Coleman, Francis Fukuyama, Robert Putnam, etc.) and institutions (e.g., the European Bank for Reconstruction and Development, the International Monetary Fund, and the World Bank).

⁷See *Trafficking in Persons: The USAID Strategy for Response*, February 2003.